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The Need for American Investment in Foreign Securities

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Commerce after the War

THE problem of reviving normal commercial and financial relationships between the nations which engaged in the Great War presents questions whose complexity is baffling. At present only certain general facts can be recognized, and these group themselves about two questions: How can commerce, by which the world has come to support itself, be restored to a permanent and self-supporting basis? How will the results of this restoration differ, if at all, from pre-war conditions? Nobody will deny that Americans desire to retain the foreign markets which they have entered during the war and that this is the most important difference for us to establish between the pre-war and post-war periods. Partial answers to all of the questions involved are proposed from all sides, but whatever the starting point of discussion, any analysis of the problem of restoring normal commerce leads inevitably to a consideration of foreign exchange rates, which serve as an index by which the resultant of many factors may be judged.

Factors Underlying the Fluctuation in Exchange Rates

The General Economic Situation

The influences which bring about fluctuations in exchange are part and parcel of the general economic situation which must be examined hastily in its relation to international trade. Before America's declaration of war she had been called upon to furnish immense quantities of material both raw and manufactured. Our manufacturing facilities were increased in response to the demand for our products. In payment, gold was sent to us from Europe until one-third of the world's total supply is now in our hands. After the United States entered the war the pressure to increase industrial facilities continued, but the gold shipments from Europe ceased when our government adopted the policy of advancing funds to the Allies to cover their purchases in this country. Today the United States finds herself with a vast store of gold, which is at present useful chiefly as a basis of credit, with materially enlarged manufacturing capacity and still engaged, in part, in satisfying abnormal foreign needs. The question naturally arises whether export markets are necessary to maintain our factories in full operation. If our domestic power to consume goods has kept pace with the growth of our power to produce them, the answer is that we are as independent of Europe as formerly, but if our plants will produce merchandise in excess of the domestic demand, we must retain our foreign markets or face the prospect of curtailing production. Each individual's power of consumption depends upon the quantity of goods which his income will buy, and, although there is much conflicting evidence on this point, there seems rea-

son to believe that commodity prices have advanced almost as much as wages and salaries, and, consequently, that ability to buy has not largely increased in this country. With much greater output and but slightly, if any, greater power at home to absorb this output, we must contrive to continue selling abroad or look forward to industrial depression.

Decreased Production in Europe

Opinion is united here and abroad that the salvation of Europe lies in production, and the nations concerned are constantly heeding more closely this necessity; but they are almost helpless unless provided with the materials on which and with which to work. Mills, factories and railroads must be rebuilt; machinery and rolling stock, destroyed, worn out by over-work or carried away, must be replaced; cotton, steel, copper and raw materials generally must be supplied; and finally, the populations must be fed until the cycle of purchase, manufacture and sale can be solidly reëstablished. Confronted with this task the nations of Europe find themselves almost without reserves of raw material. Their agricultural production is greatly curtailed through reduction of man power and devastation of producing areas and available capital for reconstruction and the purchase of raw material is sorely depleted.

On the other hand, it must not be forgotten that devastation is not general, and that "Europe has a great volume of fixed physical capital, a productive soil, mines and forests, fisheries and water power, which in the aggregate constitute enormous wealth, and which, with a relatively moderate outlay of new capital, can be made highly productive again. Europe has an intelligent population, educated and skilled in industry. Europe has a great body of scientific experts, a great body of highly able financiers, a body of great statesmen. Europe has a body of skilled and enterprising business men, trained in the management of vast industries, with fine traditions of financial honor, accustomed to paying their debts. Europe has an admirably worked-out body of commercial law, and an upright judiciary trained in the administration of that law." It is inconceivable that such facilities will not combine to produce wares which we shall be glad to buy in the future, as we have been in the past. The elements of uncertainty are the time required for European industry to resume normal production, the means which will be employed to this end, and the resultant effect upon America's position in foreign trade.

Depletion of Reserves

The war has had another general effect upon all the countries that took part. By diverting the output of industry from normal fields of consumption to use in military destruction, many wants of people everywhere have been left unsatisfied. Even though reserve stocks have been exhausted, or nearly so, there is an accumulated demand which is now seeking satisfaction; and it is necessary besides to renew the stocks normally carried to insure regularity of distribution in spite of a varying rate of production. It is through this period of re-stocking that we are now passing.[1]

Naturally, this depletion of reserves

[1] December, 1919.

and accumulation of demand has progressed further in Europe than in this country, with the result that we are exporting merchandise to the limit of the financial and shipping facilities at the disposal of foreign purchasers. Europe can as yet produce very little in excess of her own needs to sell to us. These conditions have brought about a constant and vigorous demand for American dollars with which to settle for merchandise purchased, while there is no counter-demand from us for foreign currencies with which to pay for our imports. This movement has been carried to a point where the value of the money of Europe, as expressed in dollars—that is, exchange—has fallen to levels hitherto unknown in financial history,[2] rendering purchases in this country doubly dear to the British, French and Italian importer. Nobody can tell with certainty how long the present movement will continue, but present exchange rates will sooner or later operate as definitely to check our sales abroad as would a tax on exports.

Factors Involved in Settling the Trade Balance

So far it has been assumed that the nations of Europe would pay for the goods which they are buying from us with the proceeds of their sales to the United States, and this assumption is, for practical purposes, correct in so far as events to date have shown. It must not be forgotten, however, that the normal means of settlement for adverse trade balances, so-called, is the shipment of gold. This means, however, for the time being, is impossible because, in the first place, the ratio of metallic reserve behind the paper currency of Europe has been allowed to fall as far as is safe, and in the second place, we do not want more gold which, with its attendant phenomena of increased credit and purchasing power, would lead to a further advance in prices. There remains credit. If this country can contrive the means of granting credit to our former allies, they can continue to buy from us until they become once more able to offset their purchases in the world's markets by their sales, otherwise their operations will be restricted to the lowest point possible by the disadvantage of present exchange rates.

The Granting of Credit to Europe

The alternative which confronts this country's business deserves examination. Should we fail to devise some method by which credit for purchases in America can be granted to Europe, her peoples will be in precisely the same condition as the manufacturer equipped in every way to do a profitable business, but lacking the sufficient liquid capital. He may be able to scrape along and gradually accumulate sufficient profit to avail himself fully of his plant and markets, but this is a slow process during which those interested in such a concern must forego dividends for the sake of future returns. Europe can proceed along these lines, but let us remember that the dividends which will not be paid until some distant and uncertain date are the war debts due to our government from the Allies. On the other hand, by lending well within the limits of safety we can place Europe upon a

[2] On December 12, 1919, the following quotations were reached: Sterling 3.65¼, French francs 11.84, Lire 13.60.

basis of profitable production within a comparatively short time, and reasonably expect a prompt return of the money advanced by the United States during the war. Would not the capitalist interested in a sound concern be considered stupid if he failed to make an investment which would render many times the sum involved productive instead of unproductive?

Methods of Extending Credit

The credit which is required by the countries of Europe must extend over a number of years. Their need is not temporary, but will last until the sums which we may now lend can be replaced by profits accruing from the operations of industry. This fact immediately eliminates from the field certain sources of credit. The commercial banks, which must be constantly prepared to meet the demands of their depositors, cannot tie up their funds over long periods of time. The government might renew its war time policy of lending, but hope of action in this direction was abandoned when an authoritative statement was issued that further financing of Europe was a problem to be solved by the business community.

Special legislation has been introduced in the houses of Congress to meet the necessity of extending credit to the countries of Europe. The Edge Bill, which provides for federal incorporation of institutions engaged primarily in foreign and international banking, promises to be enacted into law before the present year is out.[3] This measure will undoubtedly help the general situation, but it can be reasonably questioned whether such organizations, as yet non-existant, can command the resources necessary to satisfy in any measure the needs of our Allies for time credit, for the future operations of such institutions will depend upon the measure in which they can attract the funds of the American investor, who has so far been timid in loaning his money abroad. The War Finance Corporation is authorized by special act to make advances to exporters and to banks carrying loans to exporters, the total not to exceed $1,000,000,000 in amount and no advances to run for more than five years. Under the McLean Act national banks are permitted to divert one half of the 10 per cent of their capital, which could formerly be invested in foreign banking corporations, to investment in foreign finance corporations. The Owen Bill, as introduced on July 22, 1919, called for a $1,000,000,000 corporation to make advances to foreign governments or corporations, but Congress has taken no further action on this proposal which was drawn to fulfill so useful a purpose. As a whole, the measures enacted cannot be considered adequate to meet the present situation, for only the War Finance Corporation Act can give rise to operations of longer duration than the customary short self-liquidating transactions of foreign trade, and the limit of five years, in spite of the possibility of renewals, will deter foreign borrowers from undertaking to finance fixed investments by this means. With the government no longer advancing funds to Europe, and the banks unable, from the nature of their functions, to extend these credits, the investor, individual and corporate,

[3] The president's signature was affixed to this bill on December 24, 1919.

remains as the sole source to which our Allies can appeal in their need.

Foreign Investment Securities

It is well known that Europe offers the same wide range of securities to her investors as does this country. Government, municipal and industrial issues, all present investment and speculative opportunities. At the present time of crying need from abroad for American funds there is but slight difference in the benefit to the nations of Europe through American purchase of the different classes. The usual financial machinery and the close relation between government and industry established during the war can reasonably be counted upon to place balances in this country at the disposal of those whose requirements are the most pressing. This state of affairs may not continue, however, and in any case it is desirable that the borrower come as closely as possible into relation with the lender in order to avoid the delay, expense and uncertainties of indirect dealing, particularly if cumbersome official routine is involved.

Comment upon particular European securities is out of place here, but certain elements of strength enjoyed by industry abroad deserve consideration. The fact that the nations of Europe are relatively small geographically has led them always to seek foreign markets. Before the war a constant demand for their goods from many widely scattered parts of the world was taken as a matter of course. This broad distribution has been largely responsible for the stability of economic conditions in the stronger nations of Europe, for local depression in any part of the world has been unable to affect them as it does those countries whose manufactures are largely consumed at home. The investor in British ship-building or French textile shares need fear a decline in orders much less than the holder of American industrial stocks. There can be no doubt that former consumers of European wares will seek them again as commerce becomes normal, for the fame which they have enjoyed, almost since trade began, has not been dimmed by an interruption of deliveries for five years. In addition to tradition and habit, the present exchange rates will lead the buyers of the world to satisfy their needs in Europe whenever possible.

Advantages of Foreign Securities

Through the purchase of foreign securities an additional advantage will accrue to the investor by reason of a wider geographical distribution of the properties in which he is interested. A succession of crop failures or economic depression in any one section of the world will then affect but a portion of his holdings. The introduction of stocks and bonds issued by seasoned European concerns can only add strength to any list of holdings. There is also, at present, the possibility of receiving a greatly increased yield from foreign investments through the expected return of exchange to normal.

The Significance of Loans Through Purchase of Securities

That there is in Europe at this time large opportunity for the soundest sort of investment for American capital cannot reasonably be doubted. The effect of such loans, however, is not so clear. In the first place, the proceeds

of foreign financing in this market will permit the European countries to purchase in this country the machinery and raw materials needed for immediate use without bidding for dollars in the exchange markets, that is, without causing further declines in exchange rates. The disadvantage imposed upon American goods is already severe enough without being further increased, and every additional decrease which can be avoided will mean larger sales abroad. With the added equipment and material which will result from any loans now made to Europe, her industries will be able more quickly to produce goods for export and set in motion the process which will eventually bring exchange to normal and restore the happy conditions of peaceful commerce. With every advance in exchange rates, the purchasing power in this country of all Europe's available capital will increase, larger supplies can be bought, greater quantities manufactured and exported; and thus progressively, by a cumulative process, the flow of commerce in both directions between this country and Europe will be reëstablished, perhaps more quickly than now seems probable. Some such process as this is sure to take place sooner or later in the case of the stronger European nations, and it is not the nature but the duration of the operation that will be affected by America's purchase of foreign securities. If the capital of this country is far-sighted enough to seize the present opportunity, Europe's recovery can take place quickly and to the unquestionable advantage of the United States; but if we refuse to lend our aid at this time, the recovery will be slow and will entail the loss of our foreign markets which have become essential to the prosperity of American industry.

Foreign Investments and Foreign Markets

There is another phase of the question of foreign investment which does not concern Europe and the restoration of exchange rates, that is the necessity to avoid being undersold in all markets, including our own. It is a well known fact that whenever a nation has made liberal investments outside of its own borders, a lively commerce between the lending and borrowing countries has arisen. Investment of this type is usually made for the purpose of developing new areas, and partakes of a permanent character. This country has reached a stage in economic development where our capital would naturally seek foreign outlets were it not for the fact that our investors feel that their wealth is less safe in foreign lands than in our own. This prejudice must be overcome if we are to reap the advantages of our natural resources and accumulated wealth and take our place among the great commercial nations of the world. Without markets industry is destitute; and without foreign investment foreign markets are not to be had. The alternative is to lend our money to other nations more far-seeing and enterprising, and to send them our goods to sell in the markets that they have created with our money, conceding the first place in profit and influence and the means of maintaining them to foreign nations.

When the pressing needs of Europe have been satisfied, our financiers

must turn to South America, Africa, Asia and the East Indies, where our goods have become known during the war through the inability of these markets to purchase elsewhere. The ties that have been established must be cemented by sharing their enterprises in furnishing capital. Their names and industries must become known to us as well as our own, their problems must become our problems until the nations of the world will turn to us with the assurance of sympathetic reception and an understanding consideration of their needs. Then, and then only, shall we have the international marketplace which our resources justify, and only then will the richest nation of the world be worthy of its wealth.